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Mark David Goss  
Chairman

Teresa J. Hill  
Vice Chairman

September 21, 2006

## PARTIES OF RECORD

RE: Case No. 2006-00390  
September 19, 2006  
Informal Conference

To All Parties of Record:

Enclosed please find a memorandum that has been filed in the record of the above-referenced case. Any comments regarding the contents of the memorandum should be submitted to the Commission within seven days of receipt of this letter. Any questions regarding this memorandum should be directed to Dawn McGee of the Commission Staff at 502-564-3940, extension 243.

Sincerely,

A large, stylized handwritten signature in black ink, appearing to read "Beth O'Donnell".

Beth O'Donnell  
Executive Director

Attachment

CC: Parties of Record

## INTRA-AGENCY MEMORANDUM

### KENTUCKY PUBLIC SERVICE COMMISSION

**TO:** Main Case File - Case No. 2006-00390

**FROM:** Dawn McGee, Team Leader

**DATE:** September 21, 2006

**RE:** Informal Conference of September 19, 2006

Pursuant to the Commission Staff ("Staff") notice dated September 15, 2006, an informal conference was held at the Commission's offices on September 19, 2006. A list of attendees is attached to this memorandum.

KU provided a short presentation on the debt restructuring proposed in Case No. 2006-00390 which is designed to replace its 2 outstanding issuances of secured debt with unsecured debt. A copy of KU's presentation is attached hereto. Although the interest rate and insurance premiums will be higher on unsecured debt, KU believes that it will achieve greater offsetting savings by not having to comply with certain SEC filing requirements associated with secured debt. Without secured debt, KU would no longer be required to file SEC 10Q and 10K reports. Staff questioned whether the reports that KU will continue to file pursuant to Commission and FERC requirements will be adequate and contain similar information to what is now provided in the SEC 10Q and 10K reports. KU stated that other required filings, such as FERC Form 1, would provide the same information and KU provided a binder with examples of the reports that it will continue to file.

Staff next questioned the methodology to be used by KU to solicit bids for issuing debt to ensure that the lowest available interest rate is obtained. Staff referenced the final order in Case No. 2006-00155, which requested documentation on the bids received by KU and E.ON in order to support the interest rate that Fidelia set on KU's loan. The bid information indicated that the lowest quote for KU was lower than the quotes for E.ON. KU surmised that although rare, E.ON's investors sometimes require a higher rate than KU, but the lower rate quoted for KU was used to price that debt issuance. Staff then discussed a concern that KU was obtaining interest rate quotes through informal inquiries, as opposed to taking actual bids. The e-mails used to inquire about the interest rates stated that the request was a result of the Commission's requirement and appeared to indicate that the bank could not expect KU's business in issuing the debt. KU stated that there were no more than 12 financial institutions that placed these debt issuances and that they would not submit bids if KU only used the bids to determine the lowest rate and then placed the financing with Fidelia. KU also stated that it compared the quotes to other utility debt market indicators and it believes that the quotes have always been representative of the prevailing rates. In any future applications of a similar nature, Staff suggested that KU include the market indicators and a description of other utility bonds issued close in time along with the utility's bond ratings and the interest rates.

The meeting was then adjourned.

cc: Parties of Record (without attachments)

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY )  
UTILITIES COMPANY FOR AN )  
ORDER AUTHORIZING THE )  
ISSUANCE OF SECURITIES AND THE )  
ASSUMPTION OF OBLIGATIONS )

CASE NO. 2006-00390

=====

September 19, 2006 Informal Conference

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Please sign in:

NAME

REPRESENTING

*Richard Ruff*

*PSC - Legal*

*Allison Stinson*

*KU*

*Dan Arbaugh*

*KU*

*Kent Black*

*KU*

*Kendrick Rizer*

*SKD LGP/HO*

*Aaron Dummell*

*PSC - FA*

*Andrea Edwards*

*PSC*

*JJ Johnson*

*PSC*

*Dawn McGee*

*PSC - Financial Analysis*



# **Kentucky Utilities Company**

## **Debt Restructuring**

**September 19, 2006**



# Project Description

- ◆ **Modify the existing financing contract with Fidelity Corporation to eliminate its subordinated lien on KU assets**
  - Fidelity will not require a fee to eliminate the lien
  - Anticipated Completion (4 – 6 weeks)
  
- ◆ **Defease the \$53 million 7.92% First Mortgage Bonds, Series P**
  - Replace with long-term unsecured financing from Fidelity Corporation
  - Terminate existing interest rate swap
  - Anticipated Completion ( 6 weeks)
  
- ◆ **Refinance the \$54 million Pollution Control Bond Series 10**
  - Issue new, unsecured tax-exempt pollution control debt
  - Anticipated Completion (8 weeks)
  
- ◆ **Terminate the Company Indenture**
  - Anticipated Completion (10 weeks)



# Mechanics of Process

- ◆ **Secured Fidelia debt must be restructured**
  - The release provisions contain a negative pledge requiring that the bonds remain the most senior debt outstanding after the lien falls away
  - *KU would violate this negative pledge if the secured intercompany loans remained in place*
  
- ◆ **Upon the defeasance and refinancing, all existing pollution control bonds become unsecured**
  - All tax-exempt bonds completed since 2000 include provisions that allow the release of security upon elimination of KU's first mortgage bonds
  
- ◆ **Impact on bond ratings**
  - The long-term bond ratings will change from A1/A for secured debt to A2/BBB+ for unsecured debt
    - Resulting in an estimated 10 bps increase in interest rates on non-insured floating rate debt and an estimated 7 bps increase in some bond insurance premiums
    - The ratings shift will not impact Fidelia rates because intercompany rates are set based on E.ON's superior rating
    - Bond insurance provides protection for the outstanding insured debt

# Project Economics

<u>Upfront Cash Costs</u>	{ \$ millions }
Bond Defeasance (\$53M )	(\$0.1)
PCB Refinancing (\$54M )	<u>(\$0.5)</u>
<b>Total</b>	<b>(\$0.6)</b>
<b>Present Value of Transaction ***</b>	<b>\$0.9</b>

\*\*\*Includes the increase in interest charges and bond insurance premiums, the above-mentioned issuance costs and annual administrative cost savings of **\$267,500**, as well as a four (4) year extension of maturity in connection with the \$54 million refinanced bond.



# Continuing Financial Oversight

- KPSC will continue to receive:
  - KU monthly financial statements
  - KU annual disclosures – FERC Form 1
  - KU quarterly disclosure – FERC Form 3-Q (new disclosure)
  - Jurisdictionalized quarterly income statement and balance sheet
  - E.ON U.S. Services, Inc. annual financial report of the service company – FERC Form 60
  - E.ON AG annual SEC Form 20-F
  
- KPSC will receive two new reports:
  - Unaudited comparative quarterly financial statements (income statement, balance sheet, cash flow)
  - Audited annual financial statements (income statement, balance sheet, cash flow)
    - Includes footnotes and modified Management's Discussion and Analysis
  
- Comparison of Proposed KPSC Reporting Matters (next page)

<u>10-K</u>	<u>10-Q</u>	<u>Location of Comparable Data</u>	<u>Notes</u>
Part I			
Item 1 - Business	n/a	E.ON Form 20-F	
Item 1A - Risk Factors	Part II, Item 1A - Risk Factors	Annual Report or E.ON Form 20-F	1, 3
Item 1B - Unresolved Staff Comments	n/a	Annual Report or E.ON Form 20-F	1, 3
Item 2 - Properties	n/a	FERC Form 1 or E.ON Form 20-F	
Item 3 - Legal Proceedings	Part II, Item 1 - Legal Proceedings	Annual/Quarterly Report or FERC Form 1 & 3Q	1, 3, 6
Item 4 - Submission of Matters to a Vote	Part II, Item 4 - Submission, etc.	Not applicable	
Part II			
Item 5 - Market for Common Equity	Part II, Item 2, - Unregistered Sales, etc.	Annual/Quarterly Report or FERC Form 1 & 3Q	1, 3, 6
Item 6 - Selected Financial Data	n/a	Annual/Quarterly Report or FERC Form 1 & 3Q	1, 3, 6
Item 7 - MD&A	Part I, Item 2 - MD&A	Annual Report	1, 2, 3
Item 7A - Disclosures about Market Risk	Part I, Item 3 - Disclosures, etc.	Annual Report	1, 3
Item 8 - Financial Statements	Part I, Item 1 - Financial Statements	Annual/Quarterly Report or FERC Form 1 & 3Q	1, 3, 6
Item 9 - Disagreements w/Auditors	n/a	Annual Report	1, 3
Item 9A - Controls and Procedures	Part I, Item 4 - Controls and Procedures	Annual Report	1, 3
Item 9B - Other Information	Part II, Item 5 - Other Information	Annual Report or FERC Forms 1 & 3Q	1, 3
Part III			
Item 10 - Director and Officer Info	n/a	FERC Form 1	3, 4
Item 11 - Executive Compensation	n/a	FERC Form 1	3, 4
Item 12 - Security Ownership	n/a	Not applicable	
Item 13 - Related Party Transactions	n/a	FERC Forms 1 & 3Q	3
Item 14 - Auditor Fees	n/a	Not applicable	
Part IV			
Item 15 - Exhibits	Part II, Item 6 - Exhibits	Not applicable	4, 5
	Part II, Item 3 - Defaults on Senior Securities	Annual Report, FERC Form 1	1, 3

**Notes:**

General – Chart represents accurate high-level comparison rather than technical comparison. Certain differences exist due to reporting definitions, thresholds, materiality, etc.

- (1) "Annual Report" includes an abbreviated MD&A comparable to the PSNH – sample provided, plus audited annual financial statements and notes.
- (2) Abbreviated MD&A includes summary Results of Operations and Liquidity & Capital Resources sections.
- (3) Included where material.
- (4) Variants commonly appear in rate case or other periodic requests.
- (5) Generally filed in connection with FAC, GSC, CCN or financing proceedings.
- (6) "Quarterly Report" includes proposed unaudited quarterly financial statements, without MD&A or notes.